

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :
of :
JOSEPH AND DOLORES BONANNO :
for Redetermination of a Deficiency or for :
Refund of Personal Income Tax and Unincorporated :
Business Tax under Articles 22 and 23 of the :
Tax Law for the Years 1978 through 1981. :
:

In the Matter of the Petition :
of :
JOSEPH BONANNO :
D/B/A ELWOOD MARKET OF THORNWOOD :
for Revision of a Determination or for Refund :
of Sales and Use Taxes under Articles 28 and 29 :
of the Tax Law for the Period September 1, 1981 :
through May 31, 1984. :
:

DETERMINATION

In the Matter of the Petition :
of :
ELWOOD MARKET, INC. :
for Revision of a Determination or for Refund :
of Sales and Use Taxes under Articles 28 and 29 :
of the Tax Law for the Period April 1, 1984 :
through May 31, 1984. :
:

In the Matter of the Petition :
of :
JOSEPH BONANNO, :
OFFICER OF ELWOOD MARKET, INC. :
for Revision of a Determination or for Refund :
of Sales and Use Taxes under Articles 28 and 29 :
of the Tax Law for the Period April 1, 1984 :
through May 31, 1984. :
:

Petitioners Joseph and Dolores Bonanno, 4 Wartburg Place, Valhalla, New York 10595, filed a petition for redetermination of a deficiency or for refund of personal income tax and unincorporated business tax under Articles 22 and 23 of the Tax Law for the years 1978 through 1981 (File Nos. 801185 and 801246).

Petitioner Joseph Bonanno d/b/a Elwood Market of Thornwood, 810 Commerce Street, Thornwood, New York 10594, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period September 1, 1981 through May 31, 1984 (File No. 803919).

Petitioner Elwood Market, Inc., 810 Commerce Street, Thornwood, New York 10594, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 1984 through May 31, 1984 (File No. 804228).

Petitioner Joseph Bonanno, officer of Elwood Market, Inc., 4 Wartburg Place, Valhalla, New York 10595, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 1984 through May 31, 1984 (File No. 804229).

A hearing was held before Joseph W. Pinto, Jr., Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on March 27, 1989 at 1:45 P.M., with additional information to be submitted by May 8, 1989. Petitioners appeared pro se. The Division of Taxation appeared by William F. Collins, Esq. (Lawrence A. Newman, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation properly determined additional income and unincorporated business taxes due by reference to a previous sales tax audit of Elwood Market of Thornwood for periods within tax years 1978 through 1981.

II. Whether the Division of Taxation properly determined petitioners' additional sales and use taxes due.

III. Whether petitioner Joseph Bonanno was a person required to collect tax on behalf of the corporate petitioner and is thus liable for unpaid sales and use taxes due.

FINDINGS OF FACT

On March 30, 1984 the Division of Taxation issued notices of deficiency against petitioners Joseph and Dolores Bonanno for personal income tax and unincorporated business tax due for the tax years 1978, 1979, 1980 and 1981. The amounts asserted were as follows:

Notices of Deficiency issued to Joseph and Dolores Bonanno for Personal Income Taxes

	<u>Deficiency</u>	<u>Penalty</u>	<u>Interest</u>	<u>Total</u>
1978	\$ 7,967.90	\$ 398.40	\$ 4,262.98	\$12,629.28
1979	7,270.94	363.55	3,238.20	10,872.69
1980	9,615.38	480.77	3,420.25	13,516.40

1981	<u>10,545.82</u>	<u>527.29</u>	<u>2,400.47</u>	<u>13,473.58</u>
	\$35,400.04	\$1,770.01	\$13,321.90	\$50,491.95

Notice of Deficiency issued to Joseph Bonanno
for Unincorporated Business Tax

	<u>Deficiency</u>	<u>Penalty</u>	<u>Interest</u>	<u>Total</u>
1980	\$2,497.80	\$1,136.50 ¹	\$888.47	\$4,522.77

On August 13, 1986, as the result of a field audit, the Division of Taxation issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due against petitioner Joseph Bonanno d/b/a Elwood Market of Thornwood in the amount of \$21,227.12, plus penalty and interest of \$7,878.10, for a total amount due of \$29,105.22 for the period September 1, 1981 through May 31, 1984.

On November 12, 1986, two additional notices of determination and demands for payment of sales and use taxes due were issued as the result of the same audit. These notices were issued to Elwood Market, Inc. and Joseph Bonanno, president of Elwood Market, Inc. for the period April 1, 1984 through May 31, 1984 assessing additional tax due of \$1,649.87, plus penalty and interest of \$962.29, for a total of \$2,612.16. The latter notice contained the following explanation:

"You are liable individually and as officer of Elwood Market, Inc. under Sections 1131(1) and 1133 of the Tax Law for the following taxes determined to be due in accordance with Section 1138(a) of the Tax Law."

Petitioner Joseph Bonanno owned and operated Elwood Market of Thornwood ("Elwood"), a grocery store and delicatessen which sold sandwiches and hot meals in addition to groceries, as a sole proprietorship throughout the periods encompassed by the income tax and sales tax audits which are the subject of this hearing, i.e. 1976 through March 31, 1984.

Joseph Bonanno incorporated Elwood Market as of April 1, 1984 and the notices of determination and demands for payment of sales and use taxes due issued to the corporate entity and Mr. Bonanno, as officer, resulted therefrom. He assumed the title of president of the corporate entity and performed all daily operation and management functions as its owner.

The Income Tax Audit

As indicated by Finding of Fact "1", notices of deficiency for personal income and unincorporated business taxes due for the tax years 1978 through 1981 were issued to Joseph and Dolores Bonanno as a result of an income tax audit. The Division of Taxation issued, on March 30, 1984, a Statement of Personal Income Tax Audit Changes and Statement of Unincorporated Business Tax Audit Changes which offered the following explanation for the adjustments made in those years:

¹Total penalty per Statement of Unincorporated Business Tax Audit Changes should be \$1,111.53 resulting in a total assessment of \$4,497.80.

PERSONAL INCOME TAX AUDIT CHANGES

	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	
Additional business gross receipts	\$52,135.00	\$52,085.00	\$68,417.00	\$72,249.00	
Spoilage	2,175.00	3,200.00	3,000.00	3,500.00	
Tuition deduction disallowed as unsubstantiated				<u>2,000.00</u>	
Net Adjustment	54,310.00	55,285.00	71,417.00	77,749.00	
Taxable Income Previously Stated	<u>18,785.00</u>	<u>17,554.47</u>	<u>12,520.00</u>	<u>15,843.00</u>	
Corrected Taxable Income	73,095.00	72,839.47	83,937.00	93,592.00	
Tax on Corrected Taxable Income IT-250	9,224.25	8,391.93	9,705.03	10,546.12	
Tax Previously Computed	<u>1,256.35</u>	<u>1,120.99</u>	<u>89.65</u>	<u>.30</u>	
Total Additional Tax Due	7,967.90	7,270.94	9,615.38	10,545.82	
Penalties: 685(b) negligence	398.40	363.55	480.77	527.29	
Interest	<u>4,262.98</u>	<u>3,238.20</u>	<u>3,420.25</u>	<u>2,400.47</u>	
Total	\$12,629.28	\$10,872.69	\$13,516.40	\$13,473.58	\$50,491.95

UNINCORPORATED BUSINESS TAX AUDIT CHANGES

1980

Additional gross receipts	\$68,417.00
Spoilage	3,000.00
Net Income Reported on Federal Schedule C	<u>1,028.00</u>
	72,445.00
Allowance for Taxpayer Services	(5,000.00)
Business Exemption	<u>(5,000.00)</u>
Net Adjustment per Audit	62,445.00
Taxable Business Income Previously Stated	-0-
Corrected Taxable Income	62,445.00
Tax @ 4%	2,497.80
Unincorporated Business Tax Previously Computed	-0-
Total Additional Tax Due	2,497.80
Penalties: 685(a)(1) failure to file 22½%	562.01
685(a)(2) failure to pay 17%	424.63
685(b) negligence	124.89
Interest	<u>888.47</u>
Total	\$4,522.77 ²

The income tax audit changes and unincorporated business tax audit changes were the result of a prior sales tax audit of Elwood Market of Thornwood for the periods December 1, 1975 through February 29, 1976 and September 1, 1977 through August 31, 1981. The prior audit led the Division of Taxation to conclude that Elwood Market had unreported sales from its

²Total assessment should have been \$4,497.80.

operations. The Division of Taxation proceeded to use the sales tax findings in that audit to reconstruct Schedule C gross sales for the years at issue. Review of the evidence pertaining to the prior sales tax audit indicated that the Division of Taxation utilized a markup technique to reconstruct the sales of petitioner. During the audit it was disclosed that petitioner's purchases were estimated and a markup of 46.49 percent was applied to reconstruct gross sales. In comparing the estimated purchases determined by the prior sales tax audit, the auditor responsible for the income tax audit indicated that the estimated purchases amount arrived at during the sales tax audit was actually a lower figure than purchases reported by Mr. Bonanno on his Federal Schedule C. The auditor then used the same sales tax technique in reconstructing sales, but applied the markup to the Federal purchases reported by petitioner. In addition, review of Schedule C expenses disclosed amounts for spoilage which were disallowed as already having been included in purchases. The only other adjustment was a disallowed tuition deduction which petitioner did not substantiate.

Additional sales were not assessed for unincorporated business tax purposes for years other than 1980 since it was determined during the income tax field audit that years prior to that were beyond the statute of limitations. Thus, unincorporated business tax was asserted only for 1980.

The Sales Tax Audit

The assessments referred to in Finding of Fact "2" resulted from a sales tax field audit of the grocery store and delicatessen owned by petitioner Joseph Bonanno which commenced in November 1984. Records

requested and made available during the audit included sales tax returns, Federal and State income tax returns, check disbursements journal, purchase invoices and monthly bank statements. Other records which were requested but not made available to the auditor included register tapes, sales invoices, general ledger and cash receipts journal.

According to the field audit report, Elwood's accountant had prepared worksheets which segregated cash and check purchases by nontaxable items, meats and taxable items. The auditor determined that the records provided were inadequate to verify Elwood's reported taxable sales and, in view of the lack of available records, the auditor performed a purchase markup test by analyzing the cash and check purchases for October 1981, April 1982 and February 1983 to determine taxable purchases. Invoices were not available for the check purchases; however, the auditor applied her knowledge of petitioners from her own experience to determine the taxable status of such purchases. The auditor made several requests to obtain invoices and arrange an appointment to visit the subject premises but petitioners' accountant did not accommodate her requests.

Based on the analysis of purchases made during the test period, the auditor computed taxable purchases for the audit period of approximately \$305,000.00. It was noted by the auditor in her workpapers that the taxable sales reported for the audit period were approximately \$225,000.00,³ resulting in purchases exceeding reported sales by more than \$80,000.00 for the audit period.

³Although the testimony of Ms. Reichl indicates on page 35 of the transcript that reported taxable sales were \$425,000.00, page 4 of the audit workpapers contained within the Division of Taxation's Exhibit "P" indicates taxable sales reported of \$225,000.00.

Having determined that the taxable grocery purchases were approximately \$305,000.00, the markup percentage from the prior audit for the periods 1976 through 1981 of 57.2 percent was applied to result in adjusted taxable grocery sales of \$478,402.12. Added to that amount were sandwich sales of \$37,687.50, soup sales of \$2,010.00, sales of rolls of \$3,015.00, and coffee sales of \$28,659.93 for total adjusted taxable sales of \$549,774.55. The amounts added to grocery sales for sandwiches, soups and rolls were based on the prior audit and computed as follows:

Sandwiches - 25 per day x 5 days x \$2.25	= \$281.25 per week
weeks per audit	x 134
Sandwich sales per audit	\$37,687.50

Soups - 8 per day @ 5 days @ 75¢	= \$30.00
weeks per audit	x 67
Soup sales per audit	\$2,010.00

Rolls - 10 per day @ 5 days @ 45¢	= \$22.50
weeks per audit	x 134
Rolls sold per audit	\$3,015.00

After adjusted taxable sales of \$549,774.55 were determined, the auditor allowed for reported taxable sales of \$225,416.00. This resulted in additional sales tax of \$18,650.62.

During the sales tax audit, the auditor also examined fixed expense purchase invoices available for the same three-month test period used as the subject of the sales tax audit. She determined that of the total amount of fixed expense purchases tested, 42.44 percent did not have the required tax paid. She applied this percentage to expenses purchased by both cash and check resulting in total fixed expense purchases of \$52,738.39 estimated as having no tax paid. It is from the calculation of tax due on taxable sales and tax due on expenses that the assessment of \$21,227.12, plus penalty and statutory interest, was issued. The auditor noted that in spite of having incorporated in April 1984, all sales were reported through May 1984 as a sole proprietorship. She initially prepared the audit to reflect only the sole proprietorship; however, upon revision a separate assessment was made for the final two months encompassing the corporate business period for April and May of 1984, and a Notice of Assessment Review was issued to Joseph Bonanno d/b/a Elwood Market reducing the tax due to \$19,577.25 to reflect taxes due through March 31, 1984 as a result of the change in ownership.

SUMMARY OF THE PARTIES' POSITIONS

With respect to the income tax audit, petitioners claim the unreported business receipts determined by reference to the prior sales tax audit are overstated due to the application of an unnecessary test period and markup audit, and further that the Division of Taxation's method of audit and determination of tax assessed was arbitrary and capricious.

Regarding the sales tax audit, it is Mr. Bonanno's position that he provided on behalf of the grocery store and delicatessen operations all records that were requested of him and his accountant. He further states that many of the documents were ignored and not taken into account and that the markup percentages were inaccurate and unrealistic.

The Division of Taxation contends that the field audit workpapers sufficiently explain the methods by which the assessments were calculated and contend that petitioners have not carried their burden of proof to refute them.

CONCLUSIONS OF LAW

A. In the Appellate Division decision in the Matter of Bonanno v. State Tax Commission (145 AD2d 693, 534 NYS2d 829), the court addressed petitioners' former sales tax audit for which they are now being assessed additional income taxes. In response to petitioners' contention that adequate records existed and a test period and markup audit should not have been employed, the court noted these facts and concluded as follows: "Petitioner's own representative acknowledged that insufficient records existed at the time of the audit. Further, the records produced at the hearing, nothing but a summary of available invoices and check records prepared long after the event, did not comply with the requirement that petitioner maintain original records of its sales (see, Tax Law § 1135; Matter of Goldner v State Tax Commn., 70 AD2d 978, lv denied 48 NY2d 608). Clearly, there was substantial evidence to support the finding that petitioner's records were inadequate and that a test period and markup audit was justified (see, Matter of S.H.B. Super Mkts. v. Chu, 135 AD2d 1048, 1049; Matter of Sol Wahba, Inc. v. New York State Tax Commn., 127 AD2d 943, 944)." Petitioners' remaining contention, that the Division's determination was arbitrary and capricious, was equally unpersuasive to the court. Citing Matter of S.H.B. Super Mkts. v. Chu, (*supra*, at 1050) the court addressed the burden of proof issue in the following manner: "The burden is on petitioner to establish by clear and convincing evidence that the method of audit or the amount of the tax assessed was erroneous, a burden which was not met by petitioner's inadequate financial records and general statements of dissatisfaction with the audit and its results."

The Bonanno decision, *supra*, conclusively disposes of the claims made by petitioners with respect to the computation of additional sales tax which ultimately led to the income tax deficiency. Although not specifically raised by petitioners, once it was determined that the sales tax audit was properly conducted and the tax correctly determined, the final issue to be addressed is whether the results of the sales tax audit have been employed in a proper manner to result in an income tax deficiency. Where there is some factual basis for deciding that tax returns, as filed, do not accurately reflect the true income received by a taxpayer, the Division may determine proper income using indirect methods. (See Holland v. United States, 348 US 121, 131-132; Hennekens v. State Tax Commission, 114 AD2d 599.) The sales tax audit of Elwood Market of Thornwood revealed additional sales tax due from the business. Such a determination provided a factual basis for deciding that the income reported by petitioners on their personal income tax returns was not accurate and, therefore, the Division properly raised the sales tax audit findings to calculate petitioners' personal income tax liability. No provision of the Tax Law or regulations promulgated thereunder precludes the Division of Taxation from utilizing the results of an audit conducted under one article of the Tax Law in an audit conducted under another article. (See Matter of Castaldo, State Tax Commission, February 15, 1985.) Thus, the income tax determination must stand unaltered.

B. The Tax Law imposes a tax on the retail sale of tangible personal property (Tax Law § 1105[a]), and of certain food and drink items by a grocery store and delicatessen (see, Tax Law § 1105[d]; 20 NYCRR 527.8), with the exception of items exempt under Tax Law §§ 1115 and 1105 which are inapplicable in the instant case. A vendor is obligated to maintain records of his sales for audit purposes (Tax Law § 1135) and the State, when conducting an audit, must determine the amount of tax due "from such information as may be available" but, "if necessary, the tax may be estimated on the basis of external indices" (Tax Law § 1138[a][1]). When conducting an audit, the Division of Taxation may not simply ignore a taxpayer's records if those records provide an adequate basis on which to determine the amount of tax due (Matter of Chartair, Inc. v. State Tax Commn., 65 AD2d 44); however, the Division is not required to rely upon a taxpayer's non-source documentation and determine the amount of tax due based upon general ledgers which cannot be verified (Matter of Meyer v. State Tax Commn., 61 AD2d 223, lv denied 44 NY2d 645; see also, Matter of Ronnie's Suburban Inn, Tax Appeals Tribunal,

May 11, 1989).

To determine the adequacy of a taxpayer's records, the Division must first request and thoroughly examine the taxpayer's books and records for the entire period of the proposed assessment (Matter of King Crab v. State Tax Commn., 134 AD2d 51). The purpose of this examination is to determine whether the records are so insufficient as to make it virtually impossible for the Division to verify taxable sales receipts and conduct a complete audit (Matter of Chartair, Inc. v. State Tax Commn., *supra*). Considerable latitude is given to the auditor where the taxpayer's records are inadequate. It is only necessary that the Division select an audit method reasonably calculated to reflect the tax due and then it is incumbent upon the petitioner to establish that the result of the method used is unreasonably inaccurate or that the amount of tax assessed is erroneous (Matter of Meskouris Bros. v. Chu, 139 AD2d 813). Here, the auditor made a request for all books and records pertaining to the audit period specifically to verify taxable sales, including tax returns, cash disbursements journal, purchase invoices, monthly bank statements, register tapes, the general ledger and cash receipts journal. This appears to have been a complete and adequate request for books and records. The records produced, purchase invoices for a selected test period, worksheets segregated into check purchases and cash purchases and bank statements, were used by the auditor to develop an approximation of taxable purchases, an amount comparable to total purchases indicated on petitioners' workpapers. Although purchases could be verified within a reasonable range, the auditor was not provided records that could be used to verify taxable sales. Thus, the Division of Taxation was justified in using an alternative method to determine the appropriate amount of tax due. Where the Division reasonably concludes that a taxpayer's records are not verifiable, it may employ a test period markup audit to verify the accuracy of those records and the filed returns (see, Matter of Cashelard Restaurant v. State Tax Commn., 102 AD2d 984). There is ample precedent for the use of such methods where adequate records are not available (see, Matter of Korba v. New York State Tax Commn., 84 AD2d 655). As the audit under consideration properly proceeded, the burden was upon petitioners to show that the audit methodology produced an unreasonable result or that the amount of tax assessed was erroneous (Tax Law § 1138[a][1]). Petitioners have failed to meet their burden to prove that the results of the audit were in error. Although petitioners asserted that the markup employed was in error, and suggested a lower percentage, they presented no evidence as to actual markup or a reasonable basis for the reduced amount. Absent such evidence, having been given more than ample opportunity to present the same, the Division of Taxation's method and resulting assessment must be sustained.

C. Tax Law § 1133(a) provides, in pertinent part, as follows:

"Except as otherwise provided in section eleven hundred thirty-seven, every person required to collect any tax imposed by this article shall be personally liable for the tax imposed, collected or required to be collected under this article."

D. During the period at issue, Tax Law § 1131 (former [1]) provided as follows:

"'Persons required to collect tax' or 'person required to collect any tax imposed by this article' shall include: every vendor of tangible personal property or services; every recipient of amusement charges; and every operator of a hotel. Said terms shall also include any officer or employee of a corporation or of a dissolved corporation who as such officer or employee is under a duty to act for such corporation in complying with any requirement of this article and any member of a partnership."

E. Petitioner Joseph Bonanno has failed to sustain his burden of proof to show that he was not a person required to collect tax on behalf of Elwood Market, Inc. during the period in

issue. Elwood Market, Inc. was the successor to the sole proprietorship Elwood Market of Thornwood, being operated by its president and apparent sole shareholder, Joseph Bonanno. There was no testimony or documents submitted by petitioner which indicate that anyone other than himself acted as owner, operator, shareholder, officer, and manager of all daily functions.

F. The petitions of Joseph and Delores Bonanno, Joseph Bonanno d/b/a Elwood Market of Thornwood, Elwood Market, Inc., and Joseph Bonanno, as officer of Elwood Market, Inc., are hereby denied and the Notice of Deficiency dated March 30, 1984 and the notices of determination and demands for payment of sales and use taxes due dated August 13, 1986 (as revised by the Notice of Assessment Review) and November 12, 1986 are sustained.

DATED: Troy, New York
March 1, 1990

/s/ Joseph W. Pinto, Jr.
ADMINISTRATIVE LAW JUDGE